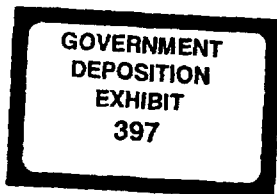


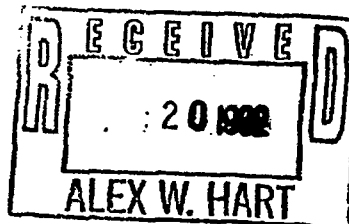
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888 Seventh Avenue  
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212 649-4600



FILE  
*Hogan*

**PERSONAL AND CONFIDENTIAL**

August 20, 1992



TO: Alex W. "Pete" Hart

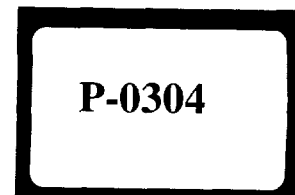
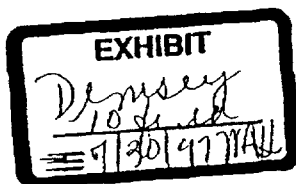
FROM: Edward J. Hogan *EH by CH*

SUBJECT: U.S. Membership

As you requested, I have been considering how MasterCard might change its U.S. position vis-a-vis Visa. I have concluded that MasterCard need rally a core group of issuers willing to compete against a pro-Visa attitude among the most important U.S. members. I have thought about what members could comprise such a needed core and what it might take to so influence them.

To start with I am influenced by the following beliefs:

- That Visa has had years of leveraging a more focused and organized corporation that has resulted in it being in a virtually unassailable position by MasterCard. That is, MasterCard in its present form competing in a dual environment. A different MasterCard can theoretically overtake Visa, but it is virtually impossible for the now existing MasterCard Association.
- A product position for MasterCard as the Number 2 brand, in effect means that it is the Number 2 brand for all issuers. It will be difficult for any member to stay committed to MasterCard under this secondary status when Visa as Number 1 is equally available to them. A far better forecast would be to have some members committed to MasterCard as their Number 1 brand. In this respect, a marketing campaign aimed at stopping Discover, while Visa stops American Express, only tends to formalize MasterCard's position as the Number 2 program. The fact that the members like our campaign is only a measure of their complacency with a secondary position for MasterCard as long as they have a primary product - Visa. (There is no second place.)
- It is very difficult if not impossible for MasterCard to devise a product, or a program, or product feature that cannot be readily duplicated by Visa. So the solution is not likely to be produced from product and/ or marketing innovation.



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- The bankcard membership will tend to consolidate behind a single brand as Discover and Optima gain in market share. It would be a natural tendency for an issuer to inordinately select a Visa card for its cardholders rather than a MasterCard, to offset perceived losses to competition. Banks will "herd", if left alone. In this respect I would predict that AT&T will commence issuing as many Visa cards as MasterCard cards in the near future. Visa will facilitate that change by soothing the past hurts. It is just too good a business opportunity for AT&T to continue to be "angry". (Our time with AT&T is now!)
- In a U.S. environment of single digit bankcard expansion, with double digit cardholder attrition, it is more and more likely that MasterCard cards will be replaced by Visa cards. This happens in two ways: (1) by the simple mathematics of the situation and (2) by deliberate tactics on the part of specific members.
- Visa is in a very strong position to leverage its member relations to further divide the common membership away from MasterCard. Most certainly there '93 and '94 programs will tend to do that. They are in a very strong position to sway their member towards issuing more and more Visa only programs. Additionally, Visa could be in a position to implement new product and/or product revisions which require their members to be dedicated to Visa only, at least for these new products or features. I feel certain they will do it. I would in their position.
- Duality will not be abolished in any formalized manner. However, members will tend to issue one or the other brand more and more prominently over the ensuing years. This "singularity" of issuance will assist Visa to the disadvantage of MasterCard. Visa will likely encourage a "de facto" abstinence of dual issuance while maintaining "de jure" duality.
- The advantage of MasterCard being able to co-brand will be more than offset by the likely loss of card issuance by financial institutions, in favor of Visa over MasterCard. Co-branding should not be confused with affinity as Visa can do the latter while only MasterCard can do the former. There are not that many co-branding opportunities for MasterCard, and frankly they will tend to further drive banks into the Visa camp. It could also influence our European partnership.
- That the MasterCard brand is a wonderful vehicle for issuers to do virtually anything they want to, if we can only get them to want to. There is nothing wrong with MasterCard that cannot be fixed by a core of dedicated issuers. There is no cure for our difficulties via consumer marketing and advertising, nor can the member relations and sales staff and all the other corporate liaisons collectively solve these ills. The cure is in a core of dedicated issuers; dedicated not dual.

In light of the above propositions, it seems to me that MasterCard International's best long term strategy it is to attract a meaningful number of members to itself as dedicated issuers of MasterCard products, in favor of Visa. In reaching this conclusion I assert:

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- That an issuer can sell MasterCard as well as Visa to consumers.
- That with less competition within MasterCard than there is within Visa, a member can actually sell more.
- That there are enough issuers who could be so influenced, that it is a meaningful strategy for MasterCard to pursue.

I believe the above to be true because I would opt for MasterCard, under the right terms. The question then becomes what would the right terms be to attract the right issuers.

To start with, in order to influence the members to make a decision as dramatic as to aligning themselves with MasterCard over Visa, we need to give them some meaningful advantages that are not otherwise available to them. A commitment to issue MasterCard is hollow unless there is actually a commitment to disproportionately issue MasterCard, or an offsetting commitment to issue less Visa. Otherwise, we will only be perpetuating the status quo while accelerating its final outcome. An issuer not committed to a particular MasterCard product, offsets any MasterCard innovation by also issuing a like Visa card, ultimately proportionately in favor of Visa. At the same time MasterCard will have spent its potential.

It should be understood that MasterCard has a limited number of potential products, features, or services can that it can use to influence issuers to select in our favor. We should not continue to expend them by allowing the general membership to distribute them equally in a dual environment while they also issue a Visa like offering. In this respect, the Gold MasterCard became such a dissipated opportunity. In that same respect, the liberalization of the designs on MasterCard cards need not have been extended to all issuers. It was matched by Visa with no lasting advantage to MasterCard. The point again is that these kinds of innovative ideas are totally neutralized in a dual world.

What I believe needs to be done is to create a special issuing capability within MasterCard as follows: (This is only by way of example, not a completed thought.)

- Be allowed to issue Gold MasterCard cards to replace all of their red & ochre MasterCards, with no minimum limits and a new benefits package.
- Allow the same members to solicit new cardholders under those same terms.
- Allow all the members to upgrade their existing Gold MasterCard cardholders to a new premium product, e.g., Platinum.

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- Allow their same members to solicit the general MasterCard membership for "Platinum" with a \$7,500 minimum credit line requirement and a new benefits package.
- Create a special red & ochre type product for youth market, national groups such as Spanish and Korean, secured card, etc.
- Create design criteria especially for the above cards. That is, allow this new Gold Card to have liberalized design criteria and create a Platinum Card and create a whole MasterCard logo faced card to distinguish these special affinity groups. Tailor these design criteria specifically for the products in question, limit there use to special designated issuing members.
- Create a positive interchange fee for these new products to incent issuance for a period of time. These incentive rates would be well within the true cost recovery amount for all interchange in general, but be greater than the normative interchange fees for the traditional like-products.
- We would build major product benefits into each of these new products, and they would be limited only to these new products as issued by the members in the group. I don't know what they might be, but we will come up with them.
- I would grandfather all existing co-branded issuance (with a separate account, not affinity) and then limit future issuance to the Charter Group.
- We would have special advertising promoting only these new MasterCard products. We would influence consumers to want these MasterCard cards over other MasterCard cards as well as Visa.

In turn, MasterCard must require members that receive the above benefits adhere to special requirements. To start with, I don't see how we can expect a dual U.S. issuer to overtly support MasterCard and Visa by either declaring themselves as MasterCard only, or by being a proactive 75%-25 issuer of MasterCard over Visa, or by dropping out of future Visa issuance. It just won't happen! Rather, we need to couch the decision to issue MasterCard as more of an "opportunity" rather than a strategical "decision." The stakes are too high for them to be otherwise so required to choose. But, if we design the "opportunity" well, we can allow an issuer to, in effect, have made a strategical decision in favor of MasterCard, without fully realizing it as such. They can be weaned back to us.

I would require the following:

- The member would pay an initiation fee in order to participate in this special issuing group of \$X million, with an assessment of .25%\$x million per year thereafter. There would be a charter period during which members could join; membership would not be allowed thereafter.

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- Each new product, e.g., New Gold, Platinum, New Red and Yellow, and the next ones, would have a predetermined issuance goal. Those goals would be reflective of the likely entire U.S. market for each product, and what percentage we could likely issue as MasterCard. (For example, 75% of the entire Gold Card issuance for MasterCard and Visa for the next three years.) These amounts would vary based upon the different products that these members would be allowed to issue within this exclusive group of members. It should be understood that the amounts paid would likely be recovered by the increased interchange fees that these members would receive from acquirers.
- We would limit the number of accounts that all these issuers could issue with each such new product, and allow them to buy "certificate of Issuance" in that issuance. For example, if we were to allow 10 million new Platinum cards to be issued over the next three years in the U.S., Citibank could buy a 25% share of that and then could issue up to 2,500,000 MasterCard Platinum accounts over the three years. We would assess Citibank as if it would have issued that many, and Citibank could not issue another account past that. That is, until MasterCard decided to raise the number of such accounts that could be issued. But then, only for that original Charter group who would bid on the new certificates of Issuance. Understand that we would establish the market offerings at a level, that if sold, ensured that Visa could not leverage its competitive response offering. Our issuers will have to issue our product; they already bought it.
- We would create an executive management committee for each of these new products and would only place the actual issuers in the group. Some matters would be voted on by "share" of the product issuance.

The candidates for this new membership group would ideally be those that issued nationally or regionally, viewing credit cards as a stand-alone business not incorporated into the whole consumer banking relationships. The very nature of this approach presumes that it is the inherent card issuing advantage afforded by MCI that will win the account away from another institution. If the institution has a credit card issuing relationship with cardholders based upon another banking relationship, then it will not need the kind of special advantages we offer. It will more likely sell a Visa card, based upon the banking relationship rather than the MasterCard International extraordinary credit card advantage offer. (We need sellers, not distributors.)

With that in mind, it becomes apparent that the likely major national issuers for MCI would be:

- Citibank
- Chemical Bank
- Bank of New York
- Marine Midland
- BancOne

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- Wells Fargo
- First USA Bank
- Primamerica
- Household
- Associates
- Colonial
- MBNA
- USAA
- First Deposit
- Universal Bank
- Monogram Bank
- GMAC Capital Corp.
- Fidelity Corp.

In addition there are a number of other strong regional banks that issue outside of their consumer banking relationships, but limit themselves to their regional marketplace, and/or institutions that have been historically friendly to MasterCard:

- Fleet, Norstar
- BayBanks
- People's Banks
- Seattle First (Unless B of A disallows it)
- SunTrust
- First Union and/or First Waichovia (To the exclusion of Nations Bank.)
- First Hawaiian
- Boatmens Bank
- First Wisconsin
- National City Bank
- National Bank of Detroit
- Mellon Bank
- Signet Bank
- Society Corp.

We do not need all of these banks in order to have a successful Association. We only need enough of them to fuel the desired mass. Frankly, we could do it with a fraction of these issuers provided they maintain the issuing appetite necessary to gain the needed cardholder mass. There are probably other issuers that are interesting and should be considered. Another potential issuer that merits some consideration is having JC Penney's Bank join so that they might convert their JC Penney's card to a co-branded MasterCard card. In this same respect we might consider offering an exclusive to two or three of the leading oil companies such as Exxon, Shell, Texaco, or Mobil. Finally, we should conclude business with the remaining RBOC and independent telephone companies. Once they understand that it is their last opportunity to participate in a co-branded MasterCard, and that Visa doesn't allow it, we might be surprised at how quick they participate. Certainly we would accelerate any decision that might happen at a

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Alex W. "Pete" Hart  
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later date when Visa could change its minds about co-branding. (Time is only on our side if we use it.)

Pete, I don't know any other way to break the viscous circle of duality that we are immersed in. By the way, I would consider extending a program like this overseas so that we separate "committed" from "dual" issuers in all countries.

It is almost a certainty that members will opt to use this new type of issuing activity to solicit cardholders, particularly MasterCard cardholders away from other MasterCard issuers. MasterCard issuers that are so displaced are those that will have essentially either opted not to participate with MasterCard in favor of Visa, like the Bank of America might, or those that are too small to fund the minimum requirements to participate. However, MasterCard cards that are issued by members that are committed to MasterCard are strategically better MasterCard accounts than those issued by members that are committed to Visa. Further, members committed to MasterCard will tend to also influence their Visa portfolio issuance in favor of MasterCard, over time. The net of this is that MasterCard may end up with a core group of committed MasterCard members issuing MasterCard cards that they want to displace Visa. In effect, we will have recast the MasterCard membership and its products.

I hope this has satisfied your request!

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